



18th May 2015

The week gone by

Global **equities** (in euro terms) fell back, mainly due to strength in the euro currency. The US S&P 500 Index, however, did hit an all-time-high in local currency terms on Friday. European equity markets have struggled in the last month, reacting adversely to the sharp fall-off in bond prices. Despite the recent move, euro currency weakness has again significantly enhanced returns for eurozone investors in 2015 (see table below). Equities continue to be supported by the expectation of reasonably strong corporate earnings' growth and low interest rates. In addition, equities remain better value relative to other asset classes despite the rise in price earnings multiples.

The global index (in euro terms) fell by 1.1% last week giving a total return year-to-date of 13.0%. The Index has dipped below its 50-day moving average but remains well above the critical 200-day moving average. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from plus 1.8% in Australia to minus 1.2% in Europe.

Eurozone **bond** prices overall were down 1.1% last week and have now lost well over 5% in the last month. Markets have suffered on the back of some stronger economic data as well as a bout of profit taking. The German 10-year bond yield rose from 0.55% to 0.62% last week having hit an all-time-low of 0.06% a month ago. Equivalent US yields were flat at 2.14%.

Commodity prices in general were up by 1.0% (in dollar terms) last week and are up 0.7% so far in 2015. The commodities index has now regained all of the losses of earlier in the year mainly due to a partial recovery in oil prices.

	Index	1 Week Return 08.05.15 to 15.05.15		Year to Date Return 31.12.14 to 15.05.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	-1.1	-1.1	13.0	13.0
US	S&P 500	0.3	-1.5	6.0	13.5
Europe	FT/S&P Europe Ex. U.K.	-1.2	-1.2	15.9	15.9
Ireland	ISEQ	-0.7	-0.7	18.4	18.4
UK	FTSE 100	-1.2	-1.1	6.0	13.5
Japan	Topix	1.2	-0.4	14.2	21.3
Hong Kong	Hang Seng	0.9	-0.9	17.9	24.8
Australia	S&P/ASX 200	1.8	1.4	6.0	10.5
Bonds	Merrill Lynch Euro over 5 year	-1.1	-1.1	1.0	1.0

The week ahead

- In the US, the bulk of Q1 earnings announcements are expected to come from the consumer/retail sector, which traditionally trails the broader index in reporting schedules. It is not expected that any substantive change in views will be reflected in the April FOMC minutes (Wednesday).
- It is estimated that euro area April final HICP and core inflation (Tuesday) remained unchanged at 0.0% year-on-year and 0.6% year-on-year respectively.
- In the UK, it is expected that the May MPC minutes (Wednesday) will show an unchanged vote of 9-0 for rates and asset purchases.
- In Japan, we look for Q1 real GDP (Tuesday) to come in at 1.6% quarter-on-quarter saar (last: 1.5%).



United States

- Mixed economic data, timing of Fed rate hikes and US dollar strength are key concerns for US investors.
- S&P 500 has been trading within a narrow range since early April. Economic data remains mixed and is not painting a particularly robust picture of the US economy. Earnings growth in Q1 2015 was around 10% yoy for S&P500 Ex Energy companies. Although this seems a robust number, aggregate EPS growth, inclusive of energy was up only 2.4% yoy and sales growth came in below expectations. Gross margin expansion drove much of the growth in EPS yoy, indicating cost savings and/or lower commodity prices is driving EPS growth as opposed to sales growth. Earnings downgrades have eased across most sectors, even for those companies with international exposure. However, domestic focused companies posted stronger sales growth in the Q1 2015 earnings reports and in the prior batch of earnings from Q4 2014, indicating the stronger dollar and lackluster international growth remains a headwind.
- EPS growth in Q1 was led by Healthcare, Financials and Tech sectors, all posting EPS growth in double digit % range. Weakest growth was seen at energy companies (EPS -53% yoy) and Telco's (EPS -7% yoy).
- The S&P 500 will continue to be dominated by macro-economic factors. The market will reward the seemingly more scarce sales growth. The strength of the US dollar has been a headwind to economic growth but with some weakening in recent weeks, the export drag may ease. Oil price, although recovered from March lows, is still down > 40% yoy and levels still create uncertainty in terms of the economic impact given the lagged effect it could have on employment, reduced capex, etc.
- 2H 2015 could see a relative improvement in economic growth, compared to a weak 1H, assuming a drop in the volatility of oil and USD. The stronger US dollar is less of an incremental headwind yoy for companies in 2H 2015 (since the dollar spot index started strengthening in mid-2014), the Fed may not move in September and hold out until Dec to raise rates and the lagged effect of the pick-up in employment may feed through more strongly to consumer spending (which has also disappointed thus far in 1H). The level of confidence in the US economic recovery being sustained is lower and until there is more clarity, the S&P500 may continue to trade within a range.

Euro Area, Europe & UK

- European Equity markets have taken a breather from their strong rally up that peaked mid-April. The relative attractiveness of the market stems from ECB's quantitative easing program (in its early stages) and fewer currency pressures. However, given the +22% move from January to mid-April, valuation looks stretched with P/E ratios well above their 10 year average. This is not unexpected at the beginning of a significant QE program and in anticipation of acceleration in growth. However, earnings revisions, although positive, have been of a small magnitude in comparison to the equity market price moves.
- Further catalysts to lift European equity markets include credible policy reform in France and Italy. Interest rates are expected to stay low for an extended period. If QE does stimulate growth in the region, this should see banks easing credit standards over time driving momentum in the growth. Political risk prevails in Europe. With the fiscal policy changes Syriza intend to implement, its unlikely Greece will achieve the previously targeted reduction in Debt (as % of GDP) from current c.174% to < 120% by 2020. With the Conservatives success in UK elections, a 2017 (or likely earlier) referendum is likely on the cards on Britain's membership.

Rest of World

- Yen should remain weak as the BOJ implements its monetary easing, a positive for inflation and exports in Japan. Japanese exports should benefit as other major economic regions grow. The gradual recovery

continues in Japan, broadly, and is supported by the continued expansion of the monetary base. Growth in private consumption (60% of GDP should pick up throughout 2015. Equity valuations in the region look attractive, relatively, and earnings revisions have turned positive. JPY depreciation, narrowing the domestic output gap, and a continued rise in prices would bring CPI inflation back to a 1% trend. Economic activity is seeing a pick up due to increased exports and better industrial production data. Japanese corporate profits are helped somewhat by the weaker yen allowing currency uplift to earnings and also the weaker oil price. China posted disappointing economic data in April, with weak real activity data and subdued inflation levels. There are no clear signs of stabilization when looking at PMI's and electricity usage and there is not much of a deceleration in the contraction in import volumes.

Central Bank Watch:

- The general economic backdrop for 2015 still continues to necessitate a reasonably loose monetary policy in several of the major regions. Policy is broadly unconventional in most regions. Some divergence is evident, with the US being closest to tightening policy.
 - In the US, the Fed is expected to withdraw some of their policy accommodation with rate rises on the horizon. Consensus timeline for a Fed Funds rate hike moved from June out to September, however, we expect it could be Dec 2015 before action is taken.
 - ECB announced a sizable, open ended Quantitative Easing program. From March 2015, the ECB will commence buying €60bn of private and public sector securities every month until end-September 2016 at least. President Draghi said the program will *"be conducted until we see a sustained adjustment in the path of inflation which is consistent with (our) aim of achieving inflation rates below, but close to, 2% over the medium term"*. The program will represent at least €1.1tn of asset purchases, possibly more if inflation and growth fails to pick up during the next year. The move should re-anchor inflation expectations and fears of deflation should be curbed.
 - The MPC unanimously support an unchanged policy stance, causing the market to push out rate rise expectations. The BoE downgraded its growth forecast but maintains its expectation on labor force slack and inflation. Fiscal policy is expected to be a headwind to GDP, given the election outcome as Conservatives' policy would be more restrictive and focused on debt reduction.
 - Japanese monetary policy is expected to remain loose for some time to come given the latest announcement of further QE. Abe's efforts have broken the two-decade cycle of deflation, although, inflation is still far from the 2% target level.

Positioning

- Zurich Life funds are overweight in equities and underweight bonds versus the manager average.
- We have a preference for Spanish and Irish over German and Belgian bonds.
- In equities, we are
 - underweight UK, North America and Europe ex Ireland,
 - neutral Europe including Ireland, neutral Asia (ex Japan),
 - Overweight Ireland and Japan.
- Sector weights (at overall level) are: underweight energy and utilities, and overweight consumer goods and industrials

This outlook does not constitute an offer and should not be taken as a recommendation from Zurich Life. Advice should always be taken from an appropriately qualified professional.

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